

March 27, 2009

The Honorable Michael E. Fryzel  
Chairman  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood  
Vice Chairman  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

The Honorable Gigi Hyland  
Board Member  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Dear Chairman Fryzel, Vice Chairman Hood and Board Member Hyland,

Thank you for the opportunity to comment on the NCUA's advance notice of proposed rulemaking and request for comment concerning the Corporate Credit Union Network and its structure.

We have reviewed several commentary entries and find much common ground with several. On December 8, 2008 the Association of Corporate Credit Unions (ACCU) submitted a plan to the NCUA addressing the issues of liquidity, capital and structure. Also, we have reviewed the comments from Georgia Central Credit Union. As an active observer of what was presented there, I would like to express United 1st Federal Credit Union's support for many of the points made in the ACCU plan and the Georgia Central plan.

We appreciate NCUA's need to take action in light of recent events concerning some within the Corporate Credit Union Network. We offer the following comments on the issues for consideration:

#### **Payment System**

We agree that payment services risk in today's world is separate from investment risk. The risks are different and must be measured differently. The question that needs to be addressed should be - Is there enough capital to satisfy the entire risk profile of an institution?

There are corporates and also CUSOs today that offer an array of payment services as well as investment products and do it well. It comes down to the operational discipline of the institution as to whether they are successful or not. The current payment risk structure is in line with that in place at other types of financial institutions. We think it is unwise to vary from standard industry practice on this issue.

#### **Liquidity and Liquidity Management**

Providing liquidity by aggregating member funds and negotiating better returns on the member's behalf represents one of the cornerstone functions corporate credit unions were created to perform. However, a corporate should not be limited to just providing liquidity. The **natural person credit union** should be able to depend on **its chosen corporate** for other products as well. However, NCUA regulations should be expanded to include a requirement on the part of the corporate to conduct cash flow monitoring because providing liquidity is a vital component of corporate services.

As to the question of limiting products and services in order to preserve liquidity, we agree that it would be impossible to specify **by regulation** the types of products and services that a corporate should be limited to offering for it does not take into account the development of new technologies and services not yet developed. As we have seen with natural person credit unions, the banking industry has attempted to limit how credit unions can serve their members by claiming that certain services are not appropriate to credit unions. This does a disservice to consumers and does not allow credit unions to be competitive in their markets. If corporates were to be limited, then credit unions and by extension **consumers would feel the effects** by not being able to have affordable access to new products, services or technologies.

In the end we believe it is the role of the regulator to provide oversight and enforcement of the regulations, and not to make management decisions on behalf of the institutions it regulates.

## Field of Membership Issues

While it is true that corporates are referred to as a “network” or “system”, they are **each** democratically controlled, individual financial institutions. Each corporate approaches its business plan, investment philosophy and execution of its mission as individual institutions. Just as with natural person credit unions, they are each individual players in the larger credit union movement.

In Georgia, our corporate has chosen a conservative investment business model. Other corporates pursued more aggressive, more risky strategies. We have a concern that broad proposals to alter corporate credit union structure and field of membership have the mistaken assumption that the aggressive model is a defining characteristic determining the operational make-up of all corporates. This is not the case. Member credit unions will always need choice when it comes to support organizations like corporates.

The current issues facing the Corporate Network have not been caused by the field of membership or structure of the Corporate Network, but by market forces in the overall financial industry, and by the **investment concentration risks** assumed by **some individual corporates**. National field of membership designations alone are not what led to significant and undue risk taking, although it did create more competition and the temptation for undue risk taking. Those were choices made by the leadership of some corporates and were a function of management’s business plan and investment strategies for those institutions.

## Expanded Investment Authority

Expanded investment authorities allowed under the current Reg. 704, meant that some corporates chose to assume additional risk within their portfolio. Corporates such as Georgia Central, which followed a more conservative investment authority level managed the risk in their portfolios in such a manner as to avoid the types of OTTI and unrealized losses affecting others. We do not feel that the expanded authorities in and of themselves are the issue. Again, the problems experienced by some corporates are a function of them executing their authorities without the proper procedures and regulatory oversight in place to prevent concentration in higher risk instruments. These corporates also fell victim to pressures put on them by some large credit unions that were chasing better and higher rates. The pressure to obtain and retain this “hot money” led some corporates to take significant and unforeseen risks with their portfolios.

We agree it is ironic that some of the very credit unions that pressured some corporates to pursue higher returns are the very same that are calling for drastic changes or overhauls to the entire structure of the Corporate Network. Some of the plans being put forth are being developed by those who are not members of corporates. In our view, this does a grave disservice to members of corporates, most of whom are under \$100 million in assets and who depend on their corporate to help them provide services to their members.

We do encourage adoption of risk based capital requirements. We believe corporate capital requirements should be on par with the rest of the financial industry. Additionally we support the restructure of the investment regulations to make sure there is proper modeling of the investment risks.

### **Structure: two-tiered system**

Our corporate, Georgia Central chose to invest in US Central in support of the cooperative model whereby corporates pooled resources into an institution that could then afford the on-staff expertise to manage more complicated portfolios. Based on the regulators and rating agencies support for the execution of this business model over the years, we felt sure that Georgia Central's choice to concentrate funds in US Central was not detrimental to its mission or its members.

As submitted in the ACCU plan, United 1st Federal Credit Union supports the view that a two-tier system for select national cooperative services such as settlement broker/dealer services may be a more effective use of credit union capital into the future. If a wholesale corporate (US Central) does not offer the best value or service to enable say, Georgia Central to fulfill its mission, then we would hope that a corporate or group of corporates would have the resources and wherewithal to seek out alternate providers or to develop necessary services internally.

### **Corporate Capital Core Capital**

We agree that the present core capital ratio of 2% minimum in this economic environment has proven to be inadequate to support the potential losses. Under the ACCU plan, it was proposed that the core capital ratio should be on par with the rest of the financial industry at a minimum of 4% on a risk based formula.

Core capital presently consists of retained earnings with some corporates having raised PIC from their membership. Retained earnings cannot be the sole capital resource for the corporates. To raise a sufficient amount of core capital via retained earnings would necessitate the corporate raising their spreads on the investment products making them uncompetitive in the market place. **Therefore each corporate should have an allowable percentage of their core capital in the form of PIC.** The network should develop a standard PIC product so that there is no competition on the part of the corporates to battle for the natural person credit union capital funds. The NCUA should mandate that any service offered by a corporate should **necessitate the holding of capital with the corporate.** This form of capital would be in the form of five-year term Membership Capital Shares in order to qualify as Tier-two capital under GAAP. The capital standards should be on par, as noted, with the rest of the financial industry.

### Membership Capital

Whether or not Membership Capital is modified, it must be recognized as having value by financial rating agencies and by capital standards as outlined in Basel. As stated above concerning core capital, Membership Capital should be modified to meet Tier-Two capital standards.

Natural person credit unions should be required to maintain a contributed capital account with a corporate in order to conduct services. The calculation should be a function of balances held at the corporate. If a credit union were to give notice, a reasonable period of time for capital payback and cancellation of services with the corporate should be given.

### Risk-based capital and contributed capital requirements

NCUA should consider and implement risk-based capital for corporates consistent with that currently required of other federally regulated institutions.

### Permissible Investments

We agree that corporate credit unions' investment powers should be greater than that of the natural person credit unions in order for the corporates to add value to their members in the form of a return. The investment powers should be based on the proper infrastructure to support the amount of risk. The regulation should clearly define what is permissible, how it is to be monitored, and identify all the risk components inherent in the investments options. Any new investment product would not be allowable unless there was some history behind the instrument and a clear understanding of how it worked and the risks associated with the instrument **including concentration risk**. The regulatory agency should also have a clear understanding of the product in order to be able to monitor and measure the risk.

### Credit Risk Management

We agree that there should be a requirement for more than one rating on an investment. The lowest rating must satisfy the minimum rating requirements of the corporate regulation. Even though the rating agencies have come into question, they still represent the best opportunity to get an outside opinion on the quality of the investment. Regulation Part 704 already addresses the minimum ratings requirement when acquiring more than one rating for an investment. We agree that the current regulation is sufficient on this point.

The corporates who are holding expanded investment authorities must all have a credit department that looks into the rating to make sure there are no questionable investment attributes that may tarnish the rating agency's evaluation.

### Asset Liability Management

NCUA should require net interest income modeling and stress testing where appropriate, such as for corporates with expanded investment authorities. Credit spreads were not a leading cause of the current market dislocation, they occurred after the initial crisis as a symptom. The cause of the market dislocation was a failure by some corporates, and others in the financial world that failed to abide by prudent common sense. **It was not the type of investments they held but the number of these they held.** The corporate system has a number of existing monitoring tools that just need to be used appropriately. Corporates with expanded investment authorities need to be properly monitored to make sure they are following their modeling and stress testing procedures.

### Corporate Governance

We believe the current board structure at retail and wholesale credit unions is appropriate. As with natural person credit unions, corporates' boards are democratically elected representatives that are member-owners of our institutions. We support ongoing education and training of board members. While we believe it is appropriate to examine term limits, the time and expense to properly train board members would necessitate term length not be

so short that adequately experienced and educated board members cannot be retained. The better approach may be to limit length of time any individual board members may hold officer positions. This would ensure adequate change of leadership without squandering experienced directors.

We strongly discourage the establishment of an “outside director” category. We believe the concept is counter to the very nature of credit unions in that they are democratically controlled by their membership. We believe the introduction of outside directors would lead to inappropriate political pressures being placed on a corporate to seat individuals that do not represent the interests of the corporates’ members.

## **Closing**

Corporate credit unions are a critical component of the credit union system. They play a unique supportive role in helping many credit unions to survive, compete, and thrive in a highly competitive marketplace, but they do this as individual financial institutions.

The needs of members of corporates, as well as external market forces, are what determine corporates’ business plans. The current structure enables corporates the flexibility to respond to members’ needs and suggestions. It allows them to be innovative on their behalf. This flexibility also allows them to work with groups like NCUA on small credit union initiatives or to work with our individual State Leagues and Associations to develop specialized programs for the benefit of their members.

As a credit union belonging to Georgia Central Credit Union, United 1st Federal Credit Union takes its membership status very seriously. We live the credit union movement message of cooperative ownership, and we understand quite clearly the rights and responsibilities that go with it as members-owners. We look at what is going on in our industry and we are glad that our corporate is here for us. As member-owners we would be just as quick to speak out if we felt that our corporate was not living up to expectations. We value the relationship we have with Georgia Central because they do a better job for us as members. Time and again we have shown support for our corporate because we want it to succeed on behalf of the members.

We respectfully ask that any plan addressing corporates should respect the individuality of each corporate while focusing on appropriate regulatory requirements for all.

We hope that you find these comments helpful as you evaluate any potential changes to the corporate credit union regulation.

Sincerely,

A handwritten signature in dark ink, reading "Patrick J. Conn". The signature is written in a cursive, flowing style.

Patrick Conn

CEO, United 1st Federal Credit Union